89-196

NO. _____

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1988

RAILROAD COMMISSION OF TEXAS,
Petitioner

V.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent

On Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Tenth Circuit

BRIEF OF PETITIONER THE RAILROAD COMMISSION OF TEXAS

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QUESTIONS PRESENTED

1. Whether the Tenth Circuit Court of Appeals erred in upholding FERC Opinion No. 239 which improperly usurps the State's jurisdiction to regulate "production and gathering" of natural gas, as reserved for state regulation by Section l(b) of the Natural Gas Act, 15 U.S.C. § 717(b)?

2. Whether the Tenth Circuit Court of Appeals erred in upholding FERC Opinion No. 239 which improperly usurps the State's exclusive jursidiction to designate proration units in violation of Section 103 of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3313?

3. Whether the Tenth Circuit Court of Appeals erred in not holding that FERC acted beyond its competence and abused its discretion by failing to defer to the Railroad Commission of Texas and Texas' State courts for final determination and interpreting of unsettled issues of Texas law?

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LIST OF ALL PARTIES

The following parties appeared in the proceedings before the Tenth Circuit Court of Appeals:

Anadarko Production Co.

Pan Eastern Exploration Co.

Cabot Pipeline Co.

Colorado Interstate Gas Co.

Conoco, Inc.

Lucky Bird Petroleum

Mobil Producing Texas and New Mexico, Inc.

Natural Gas Pipeline Co. of America

Northern Natural Gas Co.
a Division of Enron Corp.

Phillips Petroleum Co.

State of Texas

Railroad Commission of Texas

L.R. Spradling & V.T.Stowers
d/b/a/ Stowers Oil and Gas Co.

J.B. Watkins

Walker Operating Corp.

Dorchester Master Limited Partnership

Northern States Power Co.

Minnesota Department of Public Service

Texaco Producing, Inc.

Lake Superior District Power Co.

Iowa Public Service Co.

Inter-City Gas

Williams Natural Gas Co.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Tenth Circuit, reported at 874 F.2d 1320 (1989), appears as Exhibit A in the attached Appendix. FERC Opinion No. 239, reported at 32 FERC ¶ 61,043 (1985), appears as Exhibit B in the attached Appendix. The FERC Order denying Motions for Stay and Requests for Rehearing, reported at 33 FERC ¶ 61,207 (1985), appears as Exhibit C in the attached Appendix. The Administrative Law Judge's Recommended Decision adopted by FERC, reported at 30 FERC ¶ 63,017 (1985), appears as Exhibit D in the attached Appendix.

JURISDICTION

Judgment of the Court of Appeals affirming FERC's Opinion No. 239 was entered on April 28, 1989. No motion for rehearing was filed. Jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

Section l(b) of the Natural Gas Act, 15 U.S.C. §717 *et seq.*, as well as sections 2(8), 103 and 503 of the Natural Gas Policy Act, 15 U.S.C. §3301 *et seq.*, are involved in this cause. Various provisions contained in the Texas Natural Resources Code, §§ 85.001 *et seq.* and §§ 86.001 *et. seq.*, are also involved in this cause.

REASON FOR GRANTING THE WRIT

The issues presented in this Petition underscore the need for this Court to address the balance between state jurisdiction over production and gathering of natural gas and federal jurisdiction over the transportation and sale for resale of natural gas. To date, the courts have not clearly defined the line of demarcation between federal and state jurisdiction as contemplated under Section l(b) of the Natural Gas Act. ("NGA").

FERC's Opinion No. 239 directly interferes with Texas' system of regulation of mineral production in several of the largest oil and gas fields in the State. In administratively overruling the express provisions of the NGA, FERC ignored this Court's repeated admonitions that the regulation of production is a matter exclusively reserved to the states. In upholding FERC's action, the Tenth Circuit incorrectly concludes that FERC is simply regulating "pricing." Rather, FERC's Opinion No. 239 seeks to directly regulate production practices by requiring oil well operators to

complete their wells in accordance with a new FERC regulatory scheme. Failure by oil well operators to comply with the FERC regulatory directives results in severe penalties which would not arise under Texas' regulatory framework.

Regulation of oil and gas production is a complex task, best accomplished by state governments through the expertise of their state agencies, staffed to examine in detail all plans for production of hydrocarbons within their boundaries. The Railroad Commission of Texas ("Railroad Commission") is the regulatory agency charged with such responsibility in Texas. The Railroad Commission has historically enacted comprehensive regulatory programs necessary to establish a system ensuring the orderly, nonwasteful and equitable development of natural resources located within the State of Texas. The Railroad Commission's body of regulation involves much more than the superficial interpretation and general application of state statutory law as undertaken by FERC in this case. The Railroad Commission recently completed an exhaustive hearing which addressed a number of problems attendant to the production of hydrocarbons in the Texas Panhandle fields. As this Petition will demonstrate, FERC's misguided attempt to superficially interpret and apply state law and regulatory principles only serves to create conflict and uncertainty within the Texas regulatory arena. States must retain the rights conferred under Section l(b) of the NGA to regulate production in a full and unfettered manner based on their unique knowledge and study of their state's widely varying geologic conditions and production requirements.

Indeed, this Court has recently reaffirmed the absolute right of the state's to regulate production and gathering of natural gas. *Northwest Central Pipeline Corp. v. State Corp. Comm'n of Kansas*, __ U.S. __, 109

S.Ct. 1262 (1989). In the instant case, this Court should reenforce its earlier pronouncements in *Northwest Central*: "We are not prepared to render meaningless Congress' sweeping saving of power over production to the States . . ." Id. at _____, 109 S.Ct. at 1281. This Court should grant the writ because the judgment of the Tenth Circuit does what this Court refused to do in *Northwest Central*.

STATEMENT OF THE CASE

A. Nature of the Case.

This case arose when FERC issued Opinion No. 239 in *Stowers Oil and Gas Company, et al.*, holding that production and sale of casinghead gas by certain oil well operators in the Texas Panhandle violated the Natural Gas Act and the Natural Gas Policy Act ("NGPA"). FERC denied repeated requests by the State of Texas and the Railroad Commission to limit or defer the scope of the federal proceedings in order to avoid improper and inaccurate federal interpretation and application of unsettled issues of state law and the resulting interference such decisions would necessarily work on the state's regulatory programs.

B. The FERC Administrative Proceeding.

FERC commenced the underlying administrative proceeding on February 15, 1984, by ordering 37 oil well operators in the Panhandle fields to show cause why certain oil and gas production practices, then in use, did not constitute violations of the NGA and the NGPA. The order alleged that quantities of natural gas produced by the oil well operators under authority of Railroad Commission certification was not "casinghead gas," as defined under Texas law, and should have been sold in the interstate market at lower interstate prices.

At the outset of the FERC proceeding, the Attorney General of Texas intervened and urged FERC to limit the scope of its federal inquiry to only those jurisdictional issues affecting the dedication, sale and transportation of natural gas while deferring consideration and adjudication of many underlying, unsettled questions of state law. Noting that the FERC proceeding contemplated resolution of complex and unresolved state law issues, the State asked FERC to defer ruling pending resolution of necessary state law questions by the appropriate state tribunals. The Administrative Law Judge dismissed these requests, and after making her own determinations of the meaning and proper application of Texas law, issued her "Recommended Decision," finding that violations of the NGA and NGPA had occurred and directing that certain production practices in the Panhandle fields be terminated. 30 FERC at ¶ 63,017.

Following issuance of the Recommended Decision, the State and the Railroad Commission again urged FERC to stay its decision so as to avoid interference with ongoing state proceedings addressing the same substantive issues. On July 12, 1985, FERC issued Opinion No. 239, adopting the Recommended Decision "in its entirety, including all findings of fact and conclusions of law." 32 FERC ¶ 61,136. All requests for rehearing of Opinion No. 239 were denied. 33 FERC ¶ 61,207. Petitions for Review were filed. On April 28, 1989, the United States Court of Appeals for the Tenth Circuit upheld FERC's decision in all respects. *Walker Operating Corp. et al. v. FERC*, 874 F.2d 1320 (1989)[1].

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[1]In Opinion No. 239 FERC remanded the Administrative Law Judge's Recommended Decision against J.B. Watkins and Meyer Farms, Inc., two of the original thirty-seven respondent operators for additional evidentiary findings. Upon remand, the

(Footnote continued on next page)

C. Statement of Facts

1. The Panhandle Fields

The Panhandle Fields encompasses approximately 1.4 million acres across nine Texas counties. The fields are comprised of a series of complex formations known as the Granite Wash, Arkosic Dolomite, Brown Dolomite, and Moore County Lime. Enormous quantities of hydrocarbons are located

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ALJ conducted a second evidentiary hearing addressing limited evidentiary points specifically relating to the two named respondent operators. FERC issued Opinion No. 247 upholding the ALJ's additional evidentiary findings and adopting the findings in Recommended Decision upheld in Opinion No. 239.

Petitioner Railroad Commission sought judicial review of both FERC Opinions 239 and 247. The Tenth Circuit docketed Petitioners appeal of each of these cases separately. Petitioners Petition for Review of FERC Opinion No. 239 was docketed as *Walker Operating Co. et. al. v. FERC,* since reported at 874 F.2d 1320 (10th Cir. 1989). Petitioners Petition for Review of FERC Opinion No. 247 was docketed as *Railroad Commission et. al. v. FERC,* since reported at 874 F.2d 1338 (10th Cir. 1989). In its Opinion issued in *Railroad Commission et. al. v. FERC,* the Tenth Circuit expressly adopted its holding in *Walker Operating* as support for its denial of Petitioner Railroad Commission's Petition for Review of FERC Opinion No. 247. Inasmuch as Petitioner Railroad Commission's grounds for appeal of FERC Opinion No. 247 in *Railroad Commission et. al. v. FERC,* were the same grounds as those urged in *Walker Operating,* and inasmuch as the Tenth Circuit adopted its concurrent holding in *Walker Operating* as support for its denial of Petitioner Railroad Commission's position in *Railroad Commission et. al. v. FERC,* Petitioner Railraod Commission elects not to seek review by this Court of the Tenth Circuit's decision in *Railroad Commission et. al v. FERC.* Petitioner is of the opinion that this Court's review of the Tenth Circuit's decision in *Walker Operating* will be dispositive of all issues raised of interest to Petitioner in both cases.

throughout the fields in both liquid and gaseous phases. 30 FERC at 65,033. Although gas was first discovered in the field in 1918, gas production initially developed only incidentally through the search for oil, there being no large volume market for natural gas until the early 1930's when pipelines were first constructed to midwestern and northern markets. Early oil completion practices resulted in the production of casinghead gas which was vented into the atmosphere or flared for lack of a market.

Prompted by this significant waste of gas in the Panhandle fields and problems in other parts of the state, the Texas Legislature, in May of 1935, enacted a comprehensive oil and gas conservation statute. This statute gave the Railroad Commission broad authority to regulate the production of oil and gas in Texas in order to prevent waste and protect correlative rights.

The Railroad Commission held extensive hearings throughout 1935 to evaluate the development of the Panhandle fields in preparation for passage of comprehensive rules governing production and well completion practices. In these hearings, it became apparent that a unique problem had developed with the recent construction of gas pipelines. The pipeline companies, in order to assure themselves of a supply of gas adequate to justify the tremendous expense attendant to construction of pipelines to Chicago and other distant points, had substantially garnered most natural gas lease rights. These transactions generally severed "dry gas" rights from oil and casinghead gas rights. Because of these severances, the Railroad Commission faced a substantial correlative rights conflict not present in any other area of the state -- a need to ensure that the owners of dry gas rights and oil/casinghead gas rights would compete for separate reserves. Based on the premise that properly completed wells would compete for different and discrete

hydrocarbon deposits, the Railroad Commission established gas fields and oil fields, and provided for the formation of separate surface proration units.

In the early 1980's, certain natural gas operators sought administrative changes in the Panhandle fields well spacing and allowable production rules.[2] Thereafter, the Railroad Commission, recognizing that continued review of production practices in the Panhandle fields was warranted, convened a field-wide hearing to examine the effectiveness of the existing production rules.[3]

2. Federal Regulation

Commencing in 1954, the Federal Power Commission (the predecessor to the FERC), regulated producer sales of natural gas for resale in interstate commerce. "Dry" gas from gas wells in the Panhandle fields had generally been sold in the interstate market pursuant to certificates issued under Section 7 of the NGA. In contrast, casinghead gas produced from different oil fields underlying the same acreage had generally been sold in intrastate commerce. Prior to

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[2]On September 8, 1981, Phillips Petroleum Co. filed an application in Docket No. 10-77,314 to request the Railroad Commission to amend its special field rules applicable to all fields in the Panhandle District.

[3]In July 1985, the Railroad Commission began an investigation into oil and gas production practices in the Panhandle fields which has culminated in more than four months of open hearings, over 10,000 pages of testimony and over 1,000 exhibits. On March 20, 1989, the Railroad Commission issued an Amended Final Order which repealed previous field rule orders and adopted a comprehensive set of comprehensie new rules for the drilling, completion and operation of oil and gas wells in the fields. The Railroad Commission's Amended Final Order appears as Exhibit E in the attached Appendix.

1979, casinghead gas produced from the Panhandle oil fields neither flowed in interstate commerce nor was it subject to federal regulation. 30 FERC at 65,046. Upon its enactment, the NGPA provided that certain incentive prices were exempted from NGA jurisdiction. NGPA §601(a)(l)(B); 15 U.S.C. §3431(a)(l)(B). The determination of whether a well qualified for incentive prices under the NGPA was made the initial responsibility of the states subject to limited FERC review. NGPA §503; 15 U.S.C. §3413. Under NGPA pricing provisions the first oil well in a "new onshore oil proration unit" qualified for Section 103 incentive pricing. NGPA § 103; 15 U.S.C.§3313.

ARGUMENT

A. FERC Opinion No. 239 Exceeds FERC's Authority Under Section l(b) of the Natural Gas Act.

Section l(b) of the NGA reserves exclusive jurisdiction to the states over the "production or gathering" of natural gas. Congress intended that the states should retain such regulatory authority over the production and conservation of hydrocarbons within their boundaries. Section l(b) expressly provides: "The provisions of this chapter . . . shall not apply . . . to the production or gathering of natural gas." 12 U.S.C. §717(b).

Congress' clear recognition of the production of natural gas as an activity which the states had authority to regulate has been acknowledged by this Court. In *FPC v. Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 509 (1949)(emphasis added), the Court recognized the legislature's intent:

> [t]he legislative history of this Act is replete with evidence of the care taken by Congress to *keep the power over the production and*

> *gathering of gas within the states.* This probably occurred because the state legislatures, in the interest of conservation, had delegated broad and elaborate power to their regulatory bodies over all aspects of producing gas. The Natural Gas Act was designed to supplement state power and to produce a harmonious and comprehensive regulation of the industry. *Neither the states nor [the] federal regulatory body was to encroach upon the jurisdiction of the other.*

In the landmark decision of *Phillips Petroleum Co. v. State of Wisconsin*, 347 U.S. 672 (1954), producer sales of natural gas for resale in interstate commerce were found to be within the FPC's NGA jurisdiction. This Court, however, made clear that the physical activities, facilities and properties used to produce and gather natural gas were not within that jurisdictional conveyance:

> [i]n *FPC v. Panhandle Eastern Pipe Line Co.* . . . we observed that the "natural and clear meaning" of the phrase "production or gathering of natural gas" is that it encompasses "the producing properties and gathering facilities of a natural gas company." Similarly, in *Colorado Interstate Gas Co. v. FPC* we stated that *"[t]ransportation and sale do not include production or gathering,"* and indicated that the *"production or gathering" exemption applies to the physical activities*, facilities, and properties used in the production and gathering of natural gas.

Id. at 678 (emphasis added). Six years later, the Court took the opportunity to highlight the jurisdictional dichotomies drawn in *Phillips*:

> [t]he "production or gathering exemption relates to the physical activities, processes and facilities of production or gathering, but not to sales of the kind affirmatively subjected to Commission jurisdiction. This accommodation of the two relevant clauses of Section 1(b) give context to the national objectives of the Natural Gas Act as expounded in *Phillips*, and to the Commission's jurisdiction to accomplish them, *while in no way interfering with state regulatory power over the physical processes of production or gathering in furtherance of conservation or other legitimate state concerns.*

United Gas Improvement Co. v. Continental Oil Co. (Rayne Field), 381 U.S. 392, 402-03 (1965)(emphasis added).

In *Saturn Oil & Gas Co. v. FPC*, 250 F.2d 61 (10th Cir. 1957), *cert. denied sub nom., Humble Oil & Ref. Co. v. FPC*, 335 U.S. 956 (1958), this Court provided additional clarification to the jurisdictional bifurcation of NGA Section 1(b). *Saturn* involved a determination of the particular point in time at which exempted production and gathering operations ceased and FPC jurisdiction over sales commenced. *Saturn's* sales of natural gas were made at the wellhead, at a point in time after the gas had been brought forth from the earth (i.e. had been "produced") but before the gas had been "gathered." In citing to the seminal case of *Phillips*, the Court held:

> [t]hese cases [citations omitted] and *Colorado Interstate Gas Co. v. FPC* are referred to in the *Phillips* decision as holding that the production or gathering exemption *applies to the physical activities, facilities, and properties* used in the production and gathering of natural gas and not to the business of production and gathering. Until there is a sale of the natural gas produced by such operations and installations in interstate commerce for resale, they are exempt. *In the event of such a sale the jurisdiction of the Commission [FPC] applies but only because of the sale and only to the extent that the Natural Gas Act confers jurisdiction.*

Id. at 68.(emphasis added). Thus, by conditioning federal jurisdiction upon the physical occurrence of the first sale of natural gas, the Court inferentially affirmed that all activities relating to the drilling and extraction of natural gas are exempt from NGA regulation.

Most recently, this Court stated:

> [u]nless clear damage to federal goals would result, FERC's exercise of its authority must accommodate a State's regulation of production.

Northwest Central Pipeline Corp. v. State Corp. Comm'n of Kansas, __ U.S. __, ___ , 109 S. Ct. 1262, 1280 (1989).

While the Railroad Commission acknowledges FERC jurisdiction to determine ultimate federal issues involving dedication and pricing of natural gas, the state must always be allowed to resolve any and all

underlying state law questions relating to production and well completion practices. This scheme recognizes the proper decisional sequence required to administer both state and federal programs and is not a "heavy handed" attempt to threaten "clear damage to federal goals." Principles of federalism and comity dictate as much. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

This Court's holdings thus ratify the proposition that the production and gathering exemption applies to the *facilities* utilized in producing and gathering gas, such as wellbores, casing, and tubing, as well as to the activities of producing and gathering gas, such as well spacing, drilling, and completion practices.

While FERC has contended in the case below that the production and gathering exemption has been narrowly construed, FERC also acknowledges that "a core of activities remains beyond Commission [FERC] regulation." *Panhandle Eastern Pipe Line Co. v. TXO Prod. Corp.*, 34 FERC ¶ 61,292 at 61,524 (1986). The courts have consistently rejected FERC's attempts to dictate operators' practices in the drilling of wells, workovers, recompletions, or abandonment of wellbores producing natural gas, because this would "encroach on areas reserved to the states." *Shell Oil Co. v. FERC*, 566 F.2d 536, 539-41 (5th Cir. 1978), *aff'd per curiam*, 440 U.S. 192 (1979).

In *Panhandle Eastern*, FERC dismissed a complaint by a producer alleging drainage of dedicated interstate gas reserves caused by the production activities of producers on adjoining non-dedicated leases. Even though the interstate market may have been deprived of a fair share of the natural gas reserves, FERC ruled that it could not remedy the drainage because of the limitations of its jurisdiction over production and gathering activities. *Panhandle*

Eastern, 34 FERC at 61,525. Indeed, FERC recognized that the failure of a state to fully exercise its jurisdiction over production regulation "does not expand this Commission's jurisdiction to reach activities expressly excluded from federal regulatory purview by Section 1(b) of the NGA." *Id.*

FERC Opinion No. 239, nevertheless, undertakes to directly regulate many of the practices relating to the production of gas, contrary to Section 1(b) of the NGA and this Court's own dictates. Most, if not all of the acts and practices which FERC found to be illegal involve the "drilling and spacing of wells and the like." *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581, 603 (1945). The illegal acts cited by FERC involved completion techniques, perforation practices, well spacing, well classification, and related matters. The FERC administrative hearings considered evidence and made findings attendant to "the act of bringing forth gas from the earth," which is the essence of the "production or gathering" exemption under Section 1(b). *Saturn Oil & Gas Co. v. FPC*, 250 F.2d at 64.

In the case below, FERC relied on the Tenth Circuit's holding in *National Assoc. of Regulatory Utility Commissioners v. FERC*, 823 F.2d 1377 (10th Cir. 1987)(*"NARUC"*), which addressed FERC's jurisdiction over producing reserves. However, FERC's jurisdiction so conferred under *NARUC* is limited to FERC's consideration of the availability of gas supplies for interstate distribution purposes. Any jurisdiction so conferred must necessarily rely on state determinations of what, and which, underground hydrocarbons make up such reserves. These determinations rest upon the states' regulation of production and well-completion practices.

In light of the foregoing, FERC Opinion No. 239 represents an unprecedented and totally unwarranted

intrusion into state regulation of the production of natural gas and violates Section l(b) of the NGA. Permitting FERC to determine the manner in which oil wells and gas wells may be drilled and completed would all but eliminate the "production or gathering" exemption and deprive Texas of jurisdiction over the conservation of its natural resources, the prevention of waste, and the economical and efficient development of its mineral resources. Further, Opinion No. 239 is directly contrary to FERC's own contemporansous ruling in *Panhandle Eastern*. The Tenth Circuit judgment upholding FERC Opinion No. 239 must, therefore, be reversed.

B. FERC Improperly Interpreted and Applied Texas Law.

The Panhandle fields vary substantially in producing characteristics. The fields cover an area over 100 miles long and 20 miles wide. The producing formations are sandstones and carbonates which were deposited across a now-buried mountain range which resulted in sediment thicknesses ranging from zero (at mountain peaks) to over a thousand feet (in mountain valleys). The Railroad Commission has exhaustively examined the production practices of the Panhandle fields over the past seven years. This application of local expertise is the heartbeat of the state's jurisdictional program to regulate production and gathering.

The Railroad Commission is charged by Texas law with the duty to prevent waste and protect correlative rights. Tex. Nat. Res. Code Ann., §§ 85.001 *et seq.* and §§ 86.001 *et seq.* (Vernon 1978 & Supp. 1989). The Railroad Commission must be permitted to perform these duties on a case-by-case basis because of the existence of widely varying geologic and operating

parameters in a myriad of producing formations throughout the state.

Despite Congress's explicit denial to FERC of regulatory jurisdiction over production, FERC attempts to "back door" its way into the State's regulatory province by contending that the issues in the case below "involve the interpretation and application of federal statutes." Curiously, however, the "statutes" actually interpreted and applied by FERC to formulate and support its Opinion are Texas statutes governing the production and classification of oil and gas wells in the Panhandle fields. FERC's determination that the parties violated federal law rests exclusively on its interpretation of important questions of state law.

The FERC approach and the Texas approach to regulation of production from the Panhandle fields are not harmonious. In Opinion No. 239, FERC has made a rigid determination that each operator must identify the point of gas-oil contact in his wellbore and that casinghead gas is only that gas produced from below such point. Under FERC's approach a well having a gas-oil ratio exceeding 4146 cubic feet of gas per barrel of oil (4146:1) is improperly completed above the gas-oil contact and is taking gas that does not qualify as casinghead gas. 44 FERC ¶ 61,128 at 61,355 (1985). FERC's arbitrary determination is based on FERC's conclusion that gas-oil ratios above 4146:1 indicate improper production from a dry gas horizon.

Conversely, while the Railroad Commission would urge each operator to determine, if practicable, the point of gas-oil contact, the Railroad Commission necessarily recognizes that a gas-oil contact point cannot always be precisely determined and "where there are both producible oil and free gas horizons, there may be a transition zone of up to 50 feet between the two." Railroad Commission Amended Final Order,

Oil and Gas Docket No. 10-87,017 at 4, 18. Under Railroad Commission rules, an oil well is presumed to be properly completed if it has a gas-oil ratio of up to 5000 cubic feet of gas per barrel of oil (5000:1), unlike the 4165:1 ratio adopted by FERC. The Railroad Commission also will permit perforation of an oil wellbore whenever, "a test of the isolated 50 feet interval below the top of perforations yields enough oil on a stabilized 72 hour test to classify as a statutory oil well," *i.e.* whenever such a test of the wellbore reveals a gas-oil ratio of up to 100,000 cubic feet of gas per barrel of oil (100,000:1). Tex. Nat. Res. Code Ann. §86.002(6)(Vernon 1978). In addition, in determining whether an oil well is properly completed, the Railroad Commission would consider as guidelines perforation depth, location of wells in anomalous areas, competition with surrounding wells, and producing performances. Under Texas law an oil well complying with any one of these guidelines will be presumed to be properly drilled and completed and gas produced from such a well is presumed to qualify as casinghead gas. Thus, FERC's decision to impose an absolute and fixed standard conflicts with the Railroad Commission's determination that regulation solely by reference to a gas-oil contact is impractical. The Railroad Commission has found it necessary to regulate the Panhandle fields by establishing flexible oil well guidelines intended to prevent waste and protect correlative rights.

Not only does FERC Opinion No. 239 conflict with existing Texas law, the conflicts will become more apparent in the future as operators face compliance with two inconsistent regulatory schemes. Operators should not be expected to adhere to inconsistent regulatory systems, regardless of whether the architects of those systems purport to pursue common objectives. At present, an operator in the Panhandle fields may comply with Railroad Commission rules and

yet violate FERC's production constraints, or may comply with FERC's production rules and still breach Railroad Commission regulations. This dilemma will foster unnecessary hardship and confusion. Congress contemplated that operators should look to but one agency for rules governing proper production practices -- the Railroad Commission of Texas.

While FERC Opinion No. 239 purports to apply Texas law and specific Railroad Commission rules, it actually preempts state examination and resolution of important state regulatory issues by misinterpreting and mis-applying Texas law before the same regulatory issues have been finally resolved by the state. Where this Court would preempt state law when state law attempts to intrude into a federally occupied field, this Court should also hold that the federal regulators are barred from transgressing into a field of regulation exclusively reserved to the states by federal law. *Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238 (1984). The Tenth Circuit judgment upholding FERC Opinion No. 239 must, therefore, be reversed.

C. FERC Incorrectly Redefined the Scope of Proration Units and Thereby Unlawfully Circumvented the Exclusive State Jurisdiction to Designate Proration Units.

Many of the oil wells that FERC decided were improperly completed had previously been granted NGPA Section 103 pricing determinations by the Railroad Commission. Section 103 of the NGPA defines a new onshore production well as:

> [A]ny new well . . .
>
> (3) which is not within a *proration unit*
>
> (A) which was in existence at the time the surface drilling of such well began;

> (B) which was applicable to the reservoir from which such natural gas is produced; and
>
> (C) which applied to a well (i) which produced natural gas in commercial quantities or (ii) the surface drilling of which was begun before February 19, 1977, and which was thereafter capable of producing natural gas in commercial quantities.

NGPA §103(c); 15 U.S.C. §3313(c) (emphasis added). The NGPA defines "proration unit" to mean:

> (A) any portion of a reservoir, as *designated by the State* or Federal *agency having regulatory jurisdiction with respect to production* from such reservoir, which will effectively and efficiently drained by a single well; [or]
>
> (B) any drilling unit, production unit, or comparable arrangement, *designated* or *recognized by the State* or Federal *agency having jurisdiction with respect to production* from the reservoir, to describe that portion of such reservoir which will be effectively and efficiently drained by a single well. . . .

NGPA §2(8); 15 U.S.C. §3301(8) (emphasis added). The Railroad Commission is the jurisdictional agency in Texas to make such determinations. Accordingly, the key test for Section 103(c) well certification is that a well not be drilled in an existing proration unit, *as defined by the Railroad Commission*. Texas law simply provides that a proration unit consists of acreage assigned to a properly completed oil well. 16 Tex. Adm. Code §3.40.

Although the Railroad Commission's well category determinations became final under Section 503 of the NGPA, FERC found that many of the Section 103 wells were within existing proration units. In this regard, FERC ruled that where an oil well and a gas well are drilled on overlapping acreage, FERC can impose its own definition of a proration unit. 30 FERC at 65,048. FERC's definition of proration units under the "gas-oil contact" standard announced in Opinion No. 239, assumes that gas produced from an oil well above the point of "gas-oil" contact must have necessarily been produced from an existing gas well proration unit. Again, FERC's distorted view of its role under the NGPA violates all the clear precepts of federal and state law.

Moreover, FERC improperly exercised its jurisdiction regarding the subject wells because the Railroad Commission already had rendered final and binding well category determinations based on the statutorily-required findings of Section 103. For FERC to rule in its Opinion No. 239 that many of these same wells were completed within an existing proration unit directly contradicts the prior final determinations made by the Railroad Commission. Consequently, FERC's redefinition of proration units constitutes an impermissible exercise of jurisdiction into an area expressly reserved to the states. In addition, the Section 103 pricing determinations were not timely challenged by FERC,[4] and therefore, FERC waived its

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[4]Section 503 of the NGPA establishes the exclusive procedure for making well-category determinations under the NGPA. Section 503(a) provides that the "state agency" (in this case the Railroad Commission) is authorized to make "final" determinations for the purpose of "applying the definition of new, onshore production well under §103(c)." These determinations are then subject to limited review by FERC and once the period for

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right to reverse the prior final state determination. The Tenth Circuit judgment upholding FERC Opinion No. 239 must, therefore, be reversed.

D. FERC Erroneously Failed to Defer to Appropriate State Tribunals.

In the proceedings below, the State repeatedly urged FERC to defer its resolution of issues of federal jurisdiction until such time as appropriate State tribunals were able to fully and finally adjudicate the underlying issues of state law. This Court has acknowledged that federal courts should properly abstain from exercising jurisdiction over matters involving "difficult questions of state law bearing on policy problems of substantial public import . . . ." *Colorado River Water Cons. Dist. v. United States*, 424 U.S. 800, 817, *reh. denied*, 426 U.S. 912 (1976); *Louisiana Power & Light Co. v. City of Thibodaux*, 360 U.S. 25 (1959)

By analogy, FERC should have deferred to the State authorities when presented with the need to apply unresolved state law issues which would substantially impact the Texas regulatory program. This Court's doctrine of absention appropriately applies in the area of deferral when a federal agency seeks to resolve federal issues which impact upon and require resolution and application of state law. *Railroad Commission of Texas v. Pullman Co.*, 312 U.S. 496, 501

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FERC review is past, the determinations are binding with respect to such natural gas. The determinations may be reopened only pursuant to NGPA Section 503 which requires a hearing on each determination. In this case, the Section 103 determinations granted to the oil well operators became final and binding and FERC never moved to reopen these determinations as required under Section 503(d) of the NGPA. 33 FERC ¶ 61,421 (1985).

(1941); *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943). In this case, the Texas regulatory authorities are the proper entities to interpret the meaning of applicable state law. FERC must respect the distinction between state and federal competence. *New Orleans Pub. Serv., Inc. v. City of New Orleans*, 798 F.2d 858, 860 (5th Cir. 1986). Further, FERC has in past decisions recognized its jurisdictional limitations and deferred in favor of authoritative state action. In *Panhandle Eastern*, FERC announced that it had no jurisdiction to act in the areas of production and gathering. Likewise, FERC refused to exercise its jurisdiction in matters of local contract law:

> [a]s in *Arkla* this issue [contractual intent of the parties] is a matter of local contract law and is beyond the jurisdiction of the Commission. Once the issue of the applicability of the negotiated contract price is decided however, the Commission would have jurisdiction to decide whether the . . . contract as interpreted or reformed by the state court, in fact contains a negotiated contract price.

United Gas Pipeline Co., 27 FERC ¶ 61,196 at 61,366 (1984), *citing*, *Arkansas Louisiana Gas Co.*, 24 FERC ¶ 61,201 (1983).

FERC lacked legal authority to adjudicate the pivotal state law issues in this case. FERC's insistence on unilaterally deciding state law issues in an expedited hearing, while proceedings concerning the same and related issues were pending before Texas state courts and the Railroad Commission, and in the face of the state's repeated request to defer consideration of state law issues, is clearly a violation of the principles of federalism and comity. Further, FERC's unwillingness to consider the state's request to

hear and decide state law matters in joint session with the state's regulatory commission, as authorized under 15 U.S.C. §717(p), is further evidence of FERC's blatant ambivalence toward the state's jurisdictionally delegated authority to regulate "production and gathering." FERC erred by prematurely exercising its jurisdiction without respect for the proper jurisdictional division pronounced in the NGA and NGPA.

CONCLUSION

Review by this Court is necessary to correct the Tenth Circuit's erroneous application of federal law. Section l(b) the NGA reserves to the states the power and authority to regulate "production and gathering," and FERC, in its Opinion No. 239, has impermissibly and erroneously intruded into this area. Additionally, FERC violated the NGPA and unlawfully circumvented the exclusive state jurisdiction to designate proration units. Finally, FERC failed to defer to the express reservation of authority granted the states to make determinations of important state law issues.

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